

STATE OF IOWA  
DEPARTMENT OF COMMERCE  
UTILITIES BOARD

IN RE:  TELEPHONE ACQUISITION GROUP, LLC	DOCKET NO. DRU-99-2
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**ORDER GRANTING PETITION FOR DECLARATORY RULING**

(Issued April 30, 1999)

On April 2, 1999, the Telephone Acquisition Group, LLC (TAG), filed a petition for declaratory ruling concerning the application of the rate regulation provisions of IOWA CODE § 476.97 to a possible purchase of certain exchanges in Iowa owned by GTE Midwest Incorporated (GTE). The petition states that TAG is made up of a group of Iowa local exchange service providers that are bidding on the GTE local exchanges in Iowa. If TAG is the successful bidder, TAG states it may transfer some of the GTE exchanges to some of its members, while "many of the exchanges may be retained in a residual company which would be subject to rate regulation under Chapter 476." TAG Petition at p. 1.

**HYPOTHETICAL FACTS**

TAG does not specify the hypothetical facts it proposes the Board should use as the basis for its requested ruling. However, it appears the Board can assume the following hypothetical facts in its ruling:

1. GTE currently owns a number of local telecommunications exchanges in Iowa. GTE has more than 15,000 customers and more than 15,000 access lines in its Iowa exchanges, and GTE is therefore subject to the Board's rate regulation.

2. GTE has exercised the statutory option of price regulation pursuant to IOWA CODE § 476.97(11).

3. GTE proposes to sell all of its Iowa exchanges.

4. TAG may bid for and purchase the GTE Iowa exchanges.

5. TAG is a consortium of entities owned, controlled, or managed by existing Iowa local exchange service providers.

6. If TAG purchases the GTE exchanges in Iowa, it may transfer some of the exchanges to consortium members, who may not be subject to rate regulation pursuant to IOWA CODE § 476.1. However, many of the exchanges may be retained in a company that would be subject to rate regulation.

### **THE QUESTIONS**

TAG asks the Board for answers to two questions:

1. Does the acquisition of an exchange subject to price regulation have any regulatory impact on a nonrate-regulated company?

2. What is the impact of the acquisition of Iowa exchanges subject to price regulation upon a company which will be subject to rate regulation?

### **THE PROPOSED ANSWERS**

TAG proposes the following answers:

1. A nonrate-regulated company is not subject to price regulation for exchanges acquired from a price-regulated company.

2. A rate-regulated company may assume the price regulation requirements for exchanges acquired from a price-regulated company or not assume the price regulation requirements for those exchanges. Where not assuming, the company would be subject to traditional rate regulation with the option to file a price regulation plan under IOWA CODE § 476.97(1) or elect price regulation under IOWA CODE § 476.97(11).

#### **COMMENTS FROM OTHER INTERESTED PERSONS**

On April 15, 1999, GTE filed a letter indicating that, while GTE has not selected a buyer for its Iowa local exchange properties, GTE agrees with and supports TAG's petition.

On April 19, 1999, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed comments concerning TAG's petition. Consumer Advocate stated that it believes that whether a telephone company is exempt from rate regulation is governed by § 476.1, even after the acquisition of an exchange from a price regulated company. Thus, Consumer Advocate states that it agrees that a nonrate-regulated company will not lose its exemption merely because it acquires an exchange from a price regulated company, so long as the resulting entity still qualifies for the IOWA CODE § 476.1 exemption and the resulting corporate structure has not been "manipulated to frustrate public policy."

Consumer Advocate does not agree with TAG's proposed answer to the second question. Consumer Advocate states that it does not agree that a rate regulated acquiring company may elect, at its option, to assume or not assume the price regulation requirements for exchanges acquired from a price regulated company. Instead, Consumer Advocate believes that an exchange acquired by a rate regulated acquiring company should be governed by the plan and statutes applicable to the acquiring company's other exchanges.

Finally, Consumer Advocate argues that the local exchange carrier obligations imposed on the GTE exchanges by IOWA CODE §§ 476.95-.102 will follow these exchanges to an acquiring company pursuant to IOWA CODE § 476.96(5), which defines the LEC as the "incumbent and historical rate-regulated wireline provider of local exchange services or any successor to such person...."

### **RULING**

As a general rule, when an exchange is sold, the exchange does not take its pre-acquisition regulatory status with it. Instead, the rate regulation status will be determined by applying existing law to the characteristics of the local service provider that is the final result of the transaction.

Applying this principle to TAG's question, the answers would be as follows:

**1. TAG's First Question: Does the acquisition of an exchange subject to price regulation have any regulatory impact on a nonrate-regulated company?**

When a company that is not presently subject to rate regulation acquires an exchange that was previously subject to price regulation under GTE's statutory price plan, neither the acquiring company nor the acquired exchanges will automatically be subject to the existing GTE price regulation plan. If the acquiring company (with the addition of the acquired exchanges) has less than 15,000 customers and less than 15,000 access lines, then the acquiring company and the acquired exchanges will not be subject to the rate regulation provided in IOWA CODE ch. 476, see § 476.1. If the acquiring company (with or without the addition of the acquired exchanges) has 15,000 or more customers or access lines, then both the acquiring company and the acquired exchanges will be subject to chapter 476 rate regulation. The precise form of that regulation will be discussed below in connection with TAG's second question.

A different question may be presented if the acquiring company is not subject to rate regulation and it acquires enough new exchanges that it would be subject to rate regulation if they were all served by a single entity, but it decides instead to hold the new exchanges in a separate, affiliated entity. So, for example, if Company A has 12,000 access lines (and is therefore not currently subject to rate regulation) and it directly acquires a GTE exchange with 4,000 access lines, Company A will become subject to rate regulation. If, however, Company A holds the new GTE exchange in a separate corporate affiliate, the regulatory status of

Company A and its affiliate may depend upon facts not presented in TAG's petition. For this reason, the Board will leave situations of this nature for case-by-case determination, based upon the specific facts of each acquisition.

**2. TAG's second question: What is the impact of the acquisition of Iowa exchanges subject to price regulation upon a company which will be subject to rate regulation?**

TAG's second question concerns the impact of acquiring price-regulated exchanges on a company that will be subject to rate regulation after the acquisition.

TAG's proposed answer sets out four alternatives:

1. The acquiring company would have the option of continuing the existing price regulation plan for the acquired exchanges.
2. The acquiring company would be subject to traditional rate regulation for its entire operation, if it made no other election.
3. The acquiring company would have the option to file a price regulation plan under IOWA CODE § 476.97(1). This statute permits the company to propose a price regulation plan for Board review and approval.
4. The acquiring company would have the option to elect price regulation under IOWA CODE § 476.97(11). This statute provides a statutory price regulation plan with much more limited Board review.

TAG Petition at page 2.

Of these options, the Board finds that only Option No. 1, a right to adopt the existing GTE price regulation plan for the acquired exchanges, is not directly available to the acquiring company. Traditional rate regulation, a price regulation plan, or statutory price regulation may all be available options, if the applicable statutory requirements are satisfied.

Even Option No. 1 may be indirectly available to the purchaser. The purchaser is required to apply to the Board for approval of the proposed reorganization, see IOWA CODE § 476.77(1), and for transfer of the certificate of public convenience and necessity, see IOWA CODE § 476.29(2). In the reorganization review proceeding, the Board must consider whether ratepayers or the public interest will be detrimentally affected. In the certificate proceeding, the Board must consider whether the proposed service "will promote the public interest" (a standard applicable only to local exchange carriers, as defined in IOWA CODE

§ 476.96(5)) or is "consistent with the public interest" (the standard for other local service providers). In the past, some purchasers of local exchanges have met these standards, in part, by proposing to voluntarily freeze the pre-acquisition rates in the newly-acquired exchanges for a specific time period as a means of guaranteeing that customers will not experience an immediate rate increase as a result of the transfer. It is possible that a purchaser could offer, as a part of its reorganization application or its certificate transfer application, to assume the rates, terms, and conditions of the existing GTE price plan. The Board could then review and, if appropriate, approve that proposal as a part of either proceeding.

Finally, the Board notes the Consumer Advocate position that the local exchange carrier obligations imposed on the GTE exchanges by IOWA CODE §§ 476.95-.102 will follow these exchanges to an acquiring company pursuant to IOWA CODE § 476.96(5), which defines the LEC to mean:

[A]ny person that was the incumbent and historical rate-regulated wireline provider of local exchange services **or any successor to such person** that provides local exchange services under an authorized certificate or public convenience and necessity within a specific geographic area described in maps filed with and approved by the board as of September 30, 1992.

(Emphasis added.) GTE is a "local exchange carrier" as defined in this section.

The Consumer Advocate maintains that any purchaser of the GTE exchanges will be the successor to GTE and will therefore also be a "local exchange carrier" as defined in this section, at least to the extent of the purchased exchanges. This issue is beyond the scope of the questions asked by TAG and the Board will not rule on it at this time.

## **ORDERING CLAUSES**

### **IT IS THEREFORE ORDERED:**

1. The "Petition For Declaratory Ruling" filed on April 2, 1999, by Telephone Acquisition Group, LLC, is granted. The petition is docketed as Docket No. DRU-99-2.
2. The questions asked in the petition in this docket are answered as follows:
  - a. The answer to TAG's first question is that, based upon the hypothetical facts assumed in this order, an acquisition of an exchange subject to price regulation does not have any regulatory impact on a nonrate-

regulated company unless the acquisition gives the company 15,000 or more access lines or customers.

b. The answer to TAG's second question is that, based upon the hypothetical facts assumed in this order, the acquisition of price-regulated exchanges by a rate-regulated company would change the status of the acquired exchanges, but would not directly affect the regulatory status of any exchanges already owned by the acquiring company. If no other action were taken by the acquiring company, the acquired exchanges would be subject to traditional rate regulation. The acquiring company could elect price regulation pursuant to IOWA CODE § 476.97(11) or it could file a price regulation plan under IOWA CODE § 476.97(1)-(10). Finally, as a part of its application for review of the proposed reorganization or as a part of its application for transfer of certificate of public convenience and necessity, the acquiring company could propose to assume the rates and terms of the existing price regulation plan, which proposal the Board would then consider.

**UTILITIES BOARD**

/s/ Allan T. Thoms

/s/ Paula S. Dierenfeld

ATTEST:

/s/ Raymond K. Vawter, Jr.  
Executive Secretary

Dated at Des Moines, Iowa, this 30<sup>th</sup> day of April, 1999.